MCI's proposal that the network interface be unbundled from the local distribution facility is also illustrative of the absence of technical analysis underlying the IXCs' assertions.[28] MCI's proposal ignores the fact that the network interface provides a vital function of overvoltage (*e.g.*, lightning) protection for end users and their property. This function is required by the National Electrical Code.[29] MCI's proposal is unjustified and should be rejected.

2. Administrative Databases Are Not Network Elements.

MCI and others argue that virtually every database of the incumbent LEC must be unbundled and competing carriers should be provided access through "electronic bonding."[30] Again, their comments do not demonstrate that direct access to these databases is technically feasible or that access to these databases is needed to route, terminate, bill, or provide services as required by the 1996 Act.[31] Database services are readily available from other sources so that competitors can use them to store informa-

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28 See MCI Comments at 29.

29 See National Electrical Code, Article 800.

30 See MCI Comments at 34; see also Sprint Comments at 17 (advocating "electronic bonding").

31 As Ameritech has explained in detail, LIDB and the 800 database are the only databases that competitive telecommunications carriers need to access directly on an unbundled basis in order to route or terminate traffic, or otherwise to provide service. See Ameritech Comments at 48-50.

tion concerning their network and services. Arguments in favor of accessing this myriad of databases are thus misplaced. Mandatory access to these databases is not authorized by the 1996 Act, raises serious questions regarding access to proprietary information, and is not necessary to promote local competition.

3. SCP Access Is Not Technically Feasible.

A few parties seek unbundled access to databases and signaling through the SCP.[32] As Ameritech explained in its Comments, access to signaling and databases occurs at the Signal Transfer Point ("STP").[33] Access through the STP is both technically feasible and being provided today. Access though the SCP, in contrast, is not available today, although it may be theoretically feasible in some instances. Indeed, there is nothing in the record upon which to base a finding of technical feasibility. Like subloop unbundling, there is a myriad of technical, operational, administrative, and cost issues that can only be addressed in the context of specific requests. SCP access thus cannot be mandated universally.[34] The industry (in fora which include IXC membership) has not reached agreement on how

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32 See, e.g., AT&T Comments at 23-24; MCI Comments at 35-58.

33 See Ameritech Comments at 47-50.

34 Indeed, capabilities present at the STP and absent at SCP could risk network failure. See Pacific Telesis Group Comments at 59.

SCP unbundled access could be provided and has not set any interconnection standards. Mandating such access now would be premature, and AT&T's and MCI's demand for an immediate, national requirement is disingenuous.

4. Access To AIN Triggers Through The SCP Is Not Technically Feasible.

Unbundled access to AIN is even more nebulous than SCP access because it will need to be adapted uniquely to each network and is far less developed than the use of the SCP. AIN is neither a signaling system nor a database; it is nothing more than a service implementation option utilized by some LECs and IXCs.[35] There are no services currently provided using AIN that could not also be provided as a switch-based service. Thus, a real question exists regarding whether AIN access is really needed to provide competitive services, since the same services can be created without AIN. Again, the record in this proceeding fails to support any finding of technical feasibility. For these reasons, access to AIN triggers should be handled through specific good faith requests under section 252.

IV. THE 1996 ACT DOES NOT CONTEMPLATE THAT NETWORK ELEMENTS WOULD BE USED TO EVADE LAWFUL WHOLESALE RATES AND ACCESS CHARGES.

Citing section 251(c)(3), some IXCs argue that they should be able to combine unbundled network elements for any

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[35] See also Bell Atlantic Comments at 29.

purpose, including to provide what essentially is a resold incumbent LEC network service and a substitute for tariffed access services.[36] Given that many LEC services are priced at rates that reflect specific public policies (with some rates being below cost and some above), this result would be untenable and inconsistent with Congress's intent. To allow IXCs to use section 251(c)(3) as a vehicle for obtaining what is functionally indistinguishable from pure resale or access traffic would invite gaming of the regulatory process, produce undesirable policy results, and is inconsistent with the 1996 Act.

A. Re-bundling Of Network Elements Cannot Be Used To Undermine The Resale Provision Of Sections 251(c)(4) and 252(d)(3).

The IXCs rely on the following language in section 251(c)(3) to support their position: "[a]n incumbent local exchange carrier shall provide such *unbundled* network elements in a manner that allows *requesting carriers* to combine such elements in order to provide such telecommunications services." (emphasis added). IXCs ignore two key points in suggesting that this language permits them to order a loop and port (*i.e.*, switching)

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[36] See AT&T Comments at 27; MCI Comments at 20; Sprint Comments at 26; LDDS Worldcom ("LDDS") Comments at 39-41; see also DOJ Comments at 47. But see PUCO Comments at 34-35 (stating that requesting carriers should *not* be able to rebundle elements to provide service in a manner that avoids the resale pricing standard and the joint-marketing restrictions); MFS Comments at 40.

and combine these elements to provide local exchange service. First, to the extent an IXC orders both a loop and switching from the incumbent LEC, those elements -- which together are merely local service -- would not be provided on an "unbundled" basis. Only if each of these elements were connected separately with the IXC's own local facilities would they be unbundled from each other. The loop and switch in this scenario, therefore, would not be "unbundled" network elements under the 1996 Act. Second, because the loop and the switch (or port) would not be unbundled, IXCs ordering both would not be "combining" them to provide telecommunications services. The IXCs would simply be reselling local service obtained from the incumbent LEC at unbundled network element prices.[37]

The requesting carrier's inability to re-bundle network elements clearly does not *impair* that carrier's ability to offer that service because it can obtain that same service on a wholesale basis. Section 251(c)(3), as modified by subsection (d)(2), should be implemented by the Commission so as not to permit requesting carriers to piece together network elements in order to offer a service equivalent to one that the incumbent LEC already

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[37] See Ameritech Comments at 25 n.40 (citing *Conference Report* at 148 ("*some* [but not all] facilities and capabilities will likely need to be obtained from the incumbent as network elements") (emphasis added)).

offers at wholesale.[38] If such unbundling occurs, the wholesale pricing provisions of section 252(c)(4) must govern. Moreover, allowing the re-bundling of network elements into a service already offered for resale would enable IXCs to circumvent the section 271(e)(1) joint marketing restriction.[39]

LDDS Worldcom ("LDDS") asserts that such re-bundling will enable them to offer innovative services.[40] While Ameritech agrees that true unbundled access to network elements can increase innovation and facilitate competition, simply having an incumbent LEC combine "network elements" for a carrier to re-create one of the incumbent LEC's existing wholesale services affords no opportunity for creativity or innovation. The resold service and service comprised of re-bundled network elements are exactly the same. In fact, LDDS fails to describe any service it would offer based on existing switch software that is not offered today.

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38 See Ameritech Comments at 28. Similarly, the Commission should clarify that a service already offered for resale at wholesale rates is not a network element. For example, in cases where a requesting carrier orders custom calling features or other vertical services in conjunction with unbundled switching, the requesting carrier should pay the prevailing wholesale rate for the vertical service and the cost-based rate for the network element (*i.e.*, unbundled switching).

39 See id. at 29; see also MFS Comments at 40.

40 See LDDS Comments at 31-35, 40.

B. The IXCs' Interpretation Of Section 251(c)(3) Cannot Be Used To Evade Existing Access Charges.

Neither the 1996 Act nor the *NPRM* envision an immediate end to the existing access charge regime.[41] As Congress recognized, because the historical basis for exchange access charges is different from that which will apply to unbundled network elements, it is essential to continue applying access charges to traffic currently subject to the existing access charge regime.

IXCs, however, see it differently. They seek to use this proceeding to obtain an unintended windfall. These parties ignore that section 251(c)(2) interconnection requirements apply to those carriers offering local exchange service and exchange access. IXCs who offer only long distance services provide neither. Therefore, as the Commission and many others including the ICC recognize, incumbent LECs are not obligated to provide interconnection pursuant to section 251(c)(2) for originating or terminating interexchange traffic.[42]

Nor should IXCs be able to accomplish through section 251(c)(3) what they cannot accomplish through section 251(c)(2).

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[41] See 47 U.S.C. §§ 251(g) and (i) (expressly not displacing Commission's authority under section 201 and leaving in place existing access regime and obligations); *NPRM* paras. 159-165 (noting that section 251 does not displace existing access charge regime, but that access charge reform is needed in the near future).

[42] See ICC Comments at 50-52.

Section 251(c)(3) network elements are intended to facilitate the development of *local* competition. Thus unbundled elements should be limited to this purpose; they should not be available to avoid access charges. In other words, the nature of the traffic, not the type of carrier which is offering or receiving the traffic, determines the applicable charge.[43]

Perhaps most important, the current rate structures and access charges reflect social and regulatory policies that should not be overturned haphazardly. Rather, as the 1996 Act's provisions regarding universal service require, these existing rate structures must be examined directly, and re-balanced as necessary, to respond to changing conditions. Moreover, the 1996 Act requires that subsidies be explicit and recovered in a competitively neutral manner. The IXCs therefore should not be allowed to frustrate this re-balancing by purchasing unbundled network elements for the purpose of originating and terminating toll traffic.

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[43] See PUCO Comments at 54-55 (stating that IXCs can request interconnection and unbundled elements under sections 251(c)(2) and (c)(3), but it does not apply to an incumbent LEC's obligation to provide interconnection for the origination and termination of toll); see also Joint Comments of Bay Springs Telephone Co., Inc. et al. at 16.

V. FEDERAL PRICING STANDARDS MUST PERMIT THE RECOVERY OF RELEVANT COSTS.

A. Prices For Interconnection And Network Elements Must Be Set Above TSLRIC.

1. The Overwhelming Consensus Recognizes The Need To Recover Joint And Common Costs.

Even AT&T and MCI recognize that incumbent LECs must have the opportunity to recover joint (or shared) and common costs in prices charged to other carriers.[44] AT&T consultants Baumol, Ordover, and Willig recognize that "non-trivial common or shared costs among network elements" should be recovered.[45] Similarly, state regulators and other parties advocate the recovery of joint and common costs in the pricing of network elements.[46] For example, the PUCO indicates that prices should include incremental and joint costs plus a contribution to common costs.[47]

As stated in its Comments, Ameritech's incremental costs account for only 55% of its total costs.[48] Nevertheless,

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[44] See AT&T Comments at 61 ("Recoverable costs [not attributable to a particular network element] . . . must be allocated among the network elements that cause them."); see also MCI Comments at 66.

[45] AT&T Comments App. C at 13.

[46] See, e.g., NCTA Comments at 50; Ad Hoc Comments at 47; Consumer Federation of America Comments at 20.

[47] See PUCO Comments at 40-44; see also Office of Ohio Consumers' Counsel Comments at 23-28.

[48] See Ameritech Comments at 63.

several commenting parties, including AT&T and the Justice Department, mistakenly claim that because network elements are physical components, rather than services, virtually all costs are easily attributable to specific network elements. As a consequence, they claim that recovering joint or common costs from prices for interconnection or network elements is insignificant.[49]

This claim is erroneous for several reasons. First, by any reasonable measure, 45% of a company's costs are not insignificant. Although network investment and expenses are attributable to individual network elements, significant shared investments and expenses that are not attributable to individual network components will continue to be incurred. For example, general engineering is a process that allows for system-wide network integrity to be improved and maintained. Although some engineering will be specific to each network element, there will be many other instances of engineering necessary to provide *combinations* of network elements (*e.g.*, switching and transport) that do not encompass *all* network elements, but nevertheless create a *shared* engineering cost.

Ameritech indicated that for Ameritech Illinois incremental costs accounted for 55% of total costs with shared,

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[49] See DOJ Comments at 31-32; AT&T Comments at 62-63; see also MCI Comments at 66.

common, and residual costs accounting for the rest.[50] These incremental costs are not based on individual services. They are based on network elements. The Ameritech Illinois data presented in the Ameritech Comments thus demonstrate that all costs are not fully assignable to individual network elements, contrary to the assertions made in the *NPRM*[51] and by AT&T[52] and MCI.[53]

Second, a network element, even though unbundled, is still part of the incumbent LEC's public switched network and the act of unbundling may actually increase the level of shared costs. When unbundled switching is offered in addition to local exchange services of which switching is a component, the cost associated with the switch is attributable to both the unbundled network element and the retail service in which it is used. The greater the degree of unbundling, the greater are the shared costs.[54] As unbundling becomes more granular, costs that were fully attributable to a network service will become a shared cost

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50 See Ameritech Comments at 63.

51 See *NPRM* para. 130.

52 See AT&T Comments at 62-63.

53 See MCI Comments at 64-65.

54 AT&T consultants Baumol, Ordover, and Willig recognize this concept when they state "[a]t a finer level of disaggregation, there may well be non-trivial costs shared among various subcomponents of any particular aggregative network element." AT&T Comments App. C at 5 n.1.

to a group of unbundled network elements. For example, data center operations, system support, and related monitoring systems for call set up and routing would be a shared cost for a number of network elements, including unbundled local switching, SS7, and LIDB. Likewise, these same network support costs will be shared between the corresponding retail local exchange services, and local exchange services purchased by competitors for resale.

As customers exercise their new opportunity to choose carriers, costs common to the operation of all services will continue to be incurred. Accordingly, common costs must be recovered through the pricing of all facilities and services offered by the incumbent LEC. But if competing carriers do not pay their share of common costs, the remaining customers of the incumbent LEC ultimately will bear the entire burden of common costs.

2. Because Telecommunications Is Such A Capital Intensive Industry, Recovery Of Residual Costs Must Be Allowed.

It is widely recognized that telecommunications is a highly capital intensive business. Nowhere is this more true than in the local segment of the telecommunications marketplace which requires significant capital investment. In addition, the entire telecommunications marketplace is characterized by rapid technological change. These two characteristics combine to make the hypothetical ideal network of AT&T's costing methodology

inconsistent with reality. As a consequence, pricing of services and facilities necessarily must reflect costs that, while forward-looking at the time the investment was made, would not be contained in a TSLRIC estimate, such as those derived from the Hatfield model.

Regulation has further increased residual cost by imposing social policy obligations and uneconomic costing practices, such as overly lengthy depreciation schedules, on regulated companies. In addition, incumbent LECs have built spare capacity to meet growth and carrier-of-last-resort obligations. Rapid technological change and the capital intensive nature of the business create a large capital recovery requirement not recognized by the TSLRIC methodology that exists because of regulatory restrictions. But for past regulatory decisions, much of these costs and investments either would never have been incurred or would have been recovered long ago in higher service prices.

Residual costs can be significant in size and scope. In the case of Ameritech Illinois, annual residual costs, which include *inter alia* the TSLRIC anomaly and underdepreciation, total more than $400 million annually.

Several commenting parties, however, recommend that residual costs be ignored when computing the prices for providing

interconnection or network elements.[55] In particular, AT&T incredibly argues that only the costs that an "efficient, cost minimizing competitor" would incur should be recovered through prices.[56] AT&T not only wants costs limited to state-of-the-art technology, but also wants costs determined without reference to the incumbent LEC's actual architecture, sizing, technology, or operating decisions. AT&T would completely disregard the existing telecommunications infrastructure and instead base costs on a hypothetical new network built today using state-of-the-art technology.

AT&T's argument completely ignores section 252(d)(1), which permits the recovery of an incumbent LEC's cost (plus reasonable profit) of providing interconnection and network elements, not costs of a hypothetical carrier. Specifically, if forward-looking costs of TSLRIC are not based on the incumbent LEC's network configuration, the costs being recovered are not those incurred by the incumbent LEC, but rather are the costs of some hypothetical provider. Such a flawed methodology does not reflect the actual cost incurred by the incumbent LEC and is inconsistent with the 1996 Act.

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55 See, e.g., AT&T Comments at 57-65; MCI Comments at 73-75; Sprint Comments at 55; ALTS Comments at 33.

56 See AT&T Comments at 57-59.

Moreover, from a policy standpoint, AT&T's proposal is unwise because it discourages technical innovation and facilities-based competition. If any potential competitor can get unbundled network elements at a price that is no greater than the cost of the hypothetical, most efficient competitor, then no competitor would undertake the investment risk to construct its own facilities. A potential facilities-based competitor could never obtain a cost advantage over another competitor because the competition could always obtain network elements from the incumbent LEC at the hypothetical "most efficient cost." AT&T's proposal is therefore anticompetitive because it artificially discourages entry by potential competitors that could build a network and provide services more efficiently than the network of the incumbent LEC. According to AT&T, the price it should pay for access to network elements (based on hypothetical costs) would be lower than the actual costs incurred by the incumbent LEC. This creates the incongruous result that the incumbent LEC is unable to compete using its own facilities. Surely Congress did *not* intend such an irrational result.

3. Efficient Component Pricing May Be A Viable Method For Pricing Network Elements.

As Ameritech discussed in its Comments, efficient component pricing ("ECPR") closely parallels a method that a firm in a competitive market would employ when faced with the opportu-

nity of selling inputs to competitors.[57] AT&T consultants Baumol, Ordover, and Willig in their affidavit note that ECPR principles "are valid and serve a useful regulatory role."[58] They disclaim the applicability of ECPR in the instant situation because "[t]he existing structure of end-user prices for local telecommunications is *not* appropriate as a baseline for ECPR . . . because of the existence of cross-subsidies and rates that are not cost based."[59]

Even where end-user prices are not in line with economic principles, however, ECPR with adjustments may be the appropriate methodology for network element pricing. For example, if

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57 See Ameritech Comments at 92 (citing W.J. Baumol and J.G. Sidak, Toward Competition in Local Telephone, 99-101 (1994)); see also GTE Service Corp. Comments, Attachment 4.

58 AT&T Comments App. C. at 8.

59 Id. (emphasis in original). This statement is curious given that both Baumol and Willig testified to the applicability of ECPR in setting interconnection prices in New Zealand. Although there is no formal regulator in New Zealand, the government retains control over prices through the Kiwi share obligation that binds Telecom New Zealand. The terms of the Kiwi share require New Zealand Telecom to charge geographically averaged prices for local exchange services, mandate a flat rate (*i.e.*, non-usage sensitive) for local calling, and cap residential rates using the cost of living index -- policies that also exist in the U.S. telecommunications industry. The Kiwi share obligation was in force during the time that Baumol and Willig testified on the merits of ECPR, and Baumol has acknowledged its existence in recent writings with J. Gregory Sidak. See W.J. Baumol and J. Gregory Sidak, The Pricing of Inputs Sold to Competitors, Yale J. of Reg. 171, 190 (1994).

retail rates for some services or customers are set significantly above efficient levels in order to provide subsidies or support inefficiently low prices for other services or customers, the ECPR price recovers those subsidies and support flows from the unbundled network elements and permits competition to proceed based on those elements the competitor supplies to itself more efficiently than the incumbent.[60]

B. Mandatory "Bill-And-Keep" Is Neither Consistent With The 1996 Act Nor Economically Efficient.

The "bill-and-keep" arrangement under the 1996 Act is voluntary. Parties can negotiate such a result, and one would expect such an outcome when the termination costs of both carriers are approximately equal and the traffic is roughly balanced in each direction.[61] Those parties advocating the mandatory imposition of bill-and-keep when neither of these two conditions are met are urging the Commission to violate the statutory requirement that the terms and conditions for reciprocal compensation must allow for the recovery by each carrier of the costs associated with terminating traffic.[62]

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60 See generally Prepared Direct Testimony of Paul W. MacAvoy on behalf of Ameritech Wisconsin in Docket No. 05-TI-138 before the Public Service Commission of Wisconsin.

61 See *NPRM* para. 243.

62 See 47 U.S.C. § 252(d)(2)(B)(i).

Ameritech's experience to date is that traffic exchanged between incumbent LECs and new entrants is not balanced. For the period April 1995 through March 1996, based on final tallies of minutes-of-use information, Ameritech terminated more than twice as many minutes on competitor networks as competitors terminated on Ameritech's networks in Illinois and Michigan. Moreover, the additional costs of terminating traffic during peak hours are not zero. Given these facts, neither condition is satisfied. The Commission cannot mandate bill-and-keep arrangements.[63]

Several commenting parties alternatively suggest that bill-and-keep may be an appropriate compensation mechanism on an interim basis.[64] These parties misapprehend that the period during which new carriers first enter the local market will be the time when the traffic is most unbalanced between these new entrants and the incumbent LECs. Presumably, the traffic will become more balanced as new entrants become established in the local marketplace. A reciprocal compensation mechanism will then naturally evolve into a system where payments on one side cancel out the other. But the possibility that competition may someday

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[63] Indeed, even MCI recognizes that bill-and-keep is inappropriate where the traffic is persistently out of balance. See MCI Comments at 52; see also MFS Comments at 85.

[64] See, e.g., DOJ Comments at 33; Sprint Comments at 87; TCI Comments at 34.

reach the equivalent of bill-and-keep is no reason to ignore the traffic imbalance that will likely occur at startup.

Given the fundamental axiom that prices must reflect actual costs for economic efficiency to be achieved, mandatory bill-and-keep would be economically inefficient. Bill-and-keep arrangements may lead to overconsumption and underinvestment even in situations when traffic is balanced.

In sum, cost-based reciprocal compensation has significant advantages. Allocative efficiency is preserved because resources get allocated to their highest valued uses. The federal regulations therefore should allow, as contemplated by section 252(d)(2), the recovery of costs incurred in the transport and termination of traffic that originated on the other carrier's network.

C. The General Consensus Is That Wholesale Rates Must Equal Retail Rates Less Avoided Costs.

Virtually all commenting parties who addressed the issue are in agreement that the costs subtracted in determining wholesale rates must be offset by any additional costs incurred in providing the service on a wholesale basis in order to calculate "avoided" costs.[65] Costs that are incurred as a result of

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[65] See, e.g., PUCO Comments at 57-58, 63-64; Teleport Comments at 57; Sprint Comments at 72; MFS Comments at 74; Time Warner Comments at 71; Ameritech Comments at 79-81. But see LDDS Comments at 86 (opposing the recognition of the cost of providing services to wholesalers).

making services available on a wholesale basis are not avoided, and thus cannot be excluded in the calculation of wholesale rates under Section 252(d)(3). Although an incumbent LEC may not incur the same marketing, billing, collection, and other costs associated with retailing services to end users, it will nevertheless incur some marketing, billing, collection, and other costs when offering such services at wholesale to carriers. The 1996 Act recognizes the principle of cost causation by allowing a reduction from retail rates of costs that are actually avoided and enables incumbent LECs to recover wholesale costs from their wholesale customers.

1. Wholesale Rates Must Not Reflect An Adjustment For Costs That Are Not Avoided.

Some parties contend that the Commission should mandate a wholesale pricing methodology which, contrary to the plain language of the 1996 Act, would require subtraction not only of avoided costs, but also of other costs which are not avoided. These parties advocate that shared and common overhead costs should be subtracted in addition to those costs which are actually avoided.[66]

These arguments ignore the plain language of the 1996 Act. An incumbent LEC's costs related to common overheads and

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[66] See, e.g., AT&T Comments at 84; MCI Comments at 90-91; Telecommunications Resellers Association ("TRA") Comments at 24; LDDS Comments at 85.

joint (or shared) costs are, by definition, not avoided by offering services for resale. Nothing in the 1996 Act expressly or impliedly permits the Commission to increase the wholesale discount level beyond avoided cost to include any pro rata share of overhead. Eliminating such costs from wholesale rates thus would be directly contrary to the 1996 Act and would constitute poor public policy.

Indeed, a number of commenting parties, including competitors of Ameritech, recognize that it would be inappropriate to allocate some portion of common overheads which are not avoided to "avoided costs."[67] As MFS recognizes: "These costs will continue to be incurred regardless of whether the ILEC provides its services on wholesale or retail basis. (footnote omitted). Since joint and common costs will not be avoided in fact, they cannot be removed from wholesale rates under the pricing standard of sec. 252(d)(3)."[68]

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[67] Even MCI tacitly admits this point in discussing wholesale rates: "The ILEC is fully compensated by its competitor for its costs, less any retail costs it avoids . . . ." MCI Comments at 86; see also Time Warner Comments at 77 (avoided costs "must not include any 'mark up' or assignment of general overhead costs, or any other cost component beyond costs actually avoided by the ILEC"); Teleport Comments at 57 ("[s]tated another way, the cost of the CEO's desk is the same whether a particular local exchange line is sold at retail versus wholesale, and thus is not a cost that is 'avoided' by the wholesale transaction").

[68] MFS Comments at 74.

Such a methodology, in any event, is poor public policy. The structure and price levels adopted for wholesale offerings will significantly affect the competitive dynamics of the marketplace. The more a discount exceeds actual avoided costs, the more difficult it will be for facilities-based carriers (or resellers contemplating building out their networks) to justify the expenditure of capital dollars for network plant, thus resulting in less infrastructure investment than would otherwise occur. The excessive discount that would be generated by subtracting more than avoided costs would also provide the IXCs that advocate such an approach[69] with an unsupportable pricing advantage. With their marketing prowess, the IXCs could swamp the efforts of new facilities-based LECs to build a customer base. Setting wholesale rates lower than the avoided cost level thus would encourage entry by inefficient competitors. Inefficient competition will not serve the public interest.

One would expect competitors, of course, to advocate the largest discount they could conceivably receive. Nevertheless, unsubstantiated claims by competitors that a further discount is "required" because they need the additional margins to

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[69] See, e.g., AT&T Comments at 84; MCI Comments at 90-91; LDDS Comments at 85.

earn a profit on resold services are without merit.[70] Congress did not allow for a variable discount depending on the claims of need by competitors. The 1996 Act authorizes reduction only by avoided costs. Ultimately, the marketplace will determine whether discounts beyond an avoided cost level are economic. Facilities-based carriers, such as MFS, Teleport, and Time Warner, will be competing with Ameritech for the wholesale business of the IXCs. The marketplace, not the regulatory process, should make these determinations.

2. The 1996 Act Does Not Require A One-To-One Correspondence Between Retail And Wholesale Rates.

Several parties take the position that the resale requirements in the 1996 Act require that every rate element offered by an incumbent LEC for a particular service should be available separately on a wholesale basis.[71] These parties are wrong. The section 252(d)(3) pricing standard provides the flexibility to price wholesale services in something other than a mechanistic, formalistic way by requiring the determination of "wholesale rates *on the basis* of retail rates charged to subscribers for the telecommunication service requested . . ."

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70 See, e.g., TRA Comments at 24 (margins of 30 to 50 percent are "required").

71 For example, AT&T takes the position there must be a one-to-one correspondence between retail and wholesale rates under the 1996 Act. See AT&T Comments at 83 n.126.

(emphasis added). Although wholesale prices must be available for all retail *services*, neither the literal language of the 1996 Act nor public policy objectives require one-to-one correspondence between every retail and wholesale rate.[72]

In its region, Ameritech has developed wholesale prices for services with multiple rates, such as usage and custom calling features, on the basis of retail rates for the telecommunications service requested. Specifically, for a service that has multiple rates, Ameritech has established a weighted-average retail rate in calculating the applicable wholesale rate for that service. This methodology is consistent with the 1996 Act.

The development of average wholesale rates should result in lower prices for consumers by fostering price competition that would not otherwise exist. By divorcing the direct connection between individual retail rates and the corresponding resale rate, the Commission would encourage incumbent LECs and resellers to engage in price competition across all groups of customers. In contrast, if the Commission were to require that every discount price be made separately available for resale at wholesale rates, only the largest users selectively targeted by competitors would benefit. In turn, smaller users would be

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[72] Several parties concur that the "on the basis of" language of the 1996 Act means that wholesale rates do not have to equal retail rate structures on a rate element-by-rate element basis. See, e.g., Bell South Comments at 66-67.

denied the benefits of true price competition, at least until the development of facilities-based competition.

Use of average wholesale rates also will discourage resellers from adopting the type of copycat rate structure, which has become prevalent in the long distance marketplace, and enable resellers to design their own unique price plans. The commitment of Ameritech that its retail prices, including promotions, will not drop below the wholesale rate provided to resellers assures that a price squeeze will not occur.

VI. REASONABLE CONDITIONS AND LIMITATIONS ON RESALE ARE EXPRESSLY AUTHORIZED BY THE 1996 ACT.

A. Reasonable Conditions On Resale Are Necessary To Preserve Regulatory Policies And Are In The Public Interest.

Many states have already addressed issues relating to reasonable and nondiscriminatory conditions on resale, including at least two of the states in the Ameritech region.[73] These states have permitted reasonable restrictions on resale when justified by the public interest and specific state regulatory goals. For example, Michigan law excludes from the resale requirement any "package of services where basic local exchange service is jointly marketed or combined with other services or

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[73] See, e.g., MPSC Staff Comments at 22; PUCO Comments at 59.